The Correct Test for Determining What Law Governs an Arbitration Agreement

A huge number of shipping disputes are arbitrated. Accordingly, shipping lawyers are often as acquainted with international arbitration as they are with shipping law, by dint of this overlap.

This article follows a talk I gave at the London Shipping Law Centre in May 2020, which examined two recent English Court of Appeal judgments that address the question of what law governs an arbitration agreement. The relevance of this question can determine what disputes can be resolved by arbitration, as some disputes are arbitrable under one law but not another. Accordingly, the answer to this question can have very material practical implications for parties.

The two cases are *Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait)* [2020] EWCA Civ 6 and also *Enka v OOO* [2020] EWCA Civ 574. However, before turning to these cases it is worth recapping the English law test for determining the law governing an arbitration agreement set out in one of the leading cases *Sulamerica v Enesa Engelharia* [2012] EWCA Civ 638.

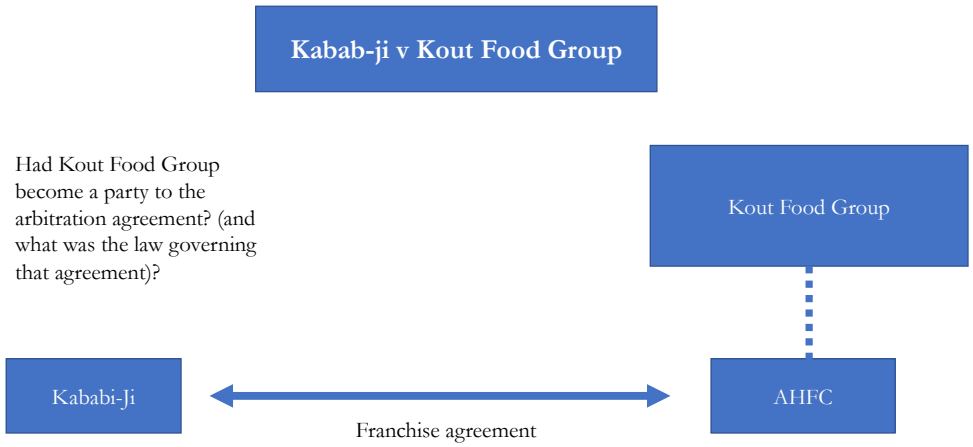
In *Sulamerica* the court explained at paragraph 25 that when faced with the question as to what law governs an arbitration agreement, the court asks:

1) Is there an express choice? If not;
2) Is there an implied choice? If not;
3) To what law does the arbitration agreement have its closest and most real connection?

In summary, *Kabab-Ji* is particularly informative in that it provides an excellent exposition of the caselaw in this area and, in particular addresses the question of "express choice". *Enka v OOO* is a more difficult judgment: it addresses the question of "implied choice" but, in this author's opinion, runs contrary to *Sulamerica* itself, leading to the consequence that there are now two contradictory Court of Appeal judgments on the correct approach to implied choice questions.

A. *Kabab-Ji v Kout Food Group*

On 20 January 2020, the Court of Appeal handed down judgment in *Kabab-Ji SAL (Lebanon) v Kout Food Group (Kuwait)* [2020] EWCA Civ 6. The background to the case is that, on 16 July 2001, the appellant, Kabab-Ji entered into a franchise contract with Al Homaizi Foodstuff Company ("AHFC") for a period of ten years. Subsequently, in 2005, AHFC became a subsidiary of KFG. A dispute arose which Kabab-Ji referred to arbitration, but naming KFG, rather than AHFC, as the respondent. KFG contested that it was a party to the arbitration agreement and that it was a party to the contract, which raised the question what law governed the arbitration agreement. On the following page I have provided a diagram of the parties' interrelationship.



The Paris tribunal (which consisted of two non-English qualified lawyers and one English-qualified lawyer), held that the arbitration agreement was governed by French law and that KFG had become a party to the arbitration by virtue of a novation inferred by the parties' conduct (the English-qualified lawyer dissenting on the question of novation). Kabab-Ji issued proceedings in the commercial court in London for enforcement of the award, in response to which KFG both filed for annulment proceedings in Paris and, on 1 March 2018, also resisted the application for enforcement in England directly by applying for an order that recognition and enforcement of the arbitration award as a judgment be refused, under section 103(2)(a) and (b) of the Arbitration Act 1996, which was the subject of the instant appeal.

The Court of Appeal was asked to decide two key issues, among others:

(1) since the parties agreed that the law governing the arbitration agreement also governed the question of whether the respondent was a party to that arbitration agreement, what was that law?

(2) If the law governing the arbitration agreement was English law, had the respondent become a party to the arbitration agreement?

As to question 1, the English court held that as a matter of interpretation the governing law clause in Article 15 of the contract was expressly intended to apply to the whole contract, including the arbitration agreement. First, Article 1 of the agreement emphasised that the phrase used – "This Agreement" – encompassed all the terms in the agreement including exhibits, schedules or amendments, without qualification, and thus included the arbitration agreement. Further, Article 15 provided that "This Agreement shall be governed by and construed by the laws of England", without qualification. Accordingly, the Court of Appeal found that there was an express choice of law governing the arbitration agreement – English law [62] (In this respect it disagreed with the Paris tribunal that French law governed the arbitration agreement).

Second, the court went on to consider the principle of separability. As to that the court explained that the rationale that an arbitration agreement is separable from the underlying contract is aimed at ensuring that the arbitration agreement survives the contract in cases where

that contract is alleged to be vitiated by fraud or misrepresentation. That does not mean, however, that arbitration agreements should not be construed with the remainder of the agreement. Their lordships opined that this was *a fortiori* where, "the clear intention is that the main agreement should be construed as a whole and where, as here, there is nothing in the wording of the arbitration agreement which suggests that it is intended to be construed in isolation from the remainder of the main agreement." [66]. The judges were keen to point out that does not mean that every arbitration agreement contained in a contract with a governing law clause will necessarily be governed by that law. Rather that, in this instance, as a matter of interpretation, that was the case. [62].

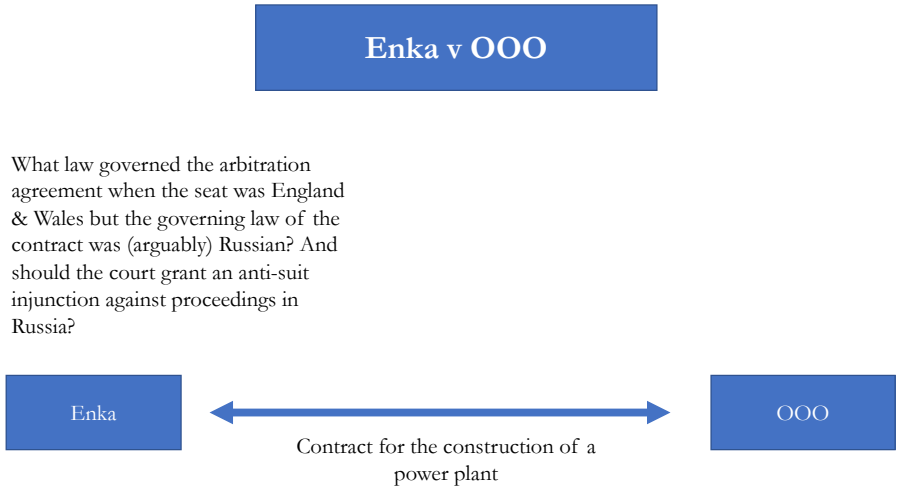
As to whether, as a matter of English law, KFG had become a party to the arbitration agreement, the court held that there was no question that KFG had agreed in writing to be added to the contract. There was also no other form of unequivocal representation by any relevant party that would establish that KFG was permitted to and/or had become a party to the contract. Accordingly, the Court of Appeal refused enforcement against KFG, as it was not a party to the arbitration agreement.

The judgment provides an exposition of the caselaw in this difficult area, tracing back to the 1993 case *Channel Tunnel v Balfour Beaty* [1993] AC 334, through *Dallah Real Estate v Ministry of Religious Affairs* [2010] UKSC 46, *Sulamerica v Enesa Engelharia* [2012] EWCA Civ 638, *C v D* [2007] EWCA Civ 1282; *BCY v BCZ* [2016] 2 Lloyd's Rep 583, and *Arsanovia v Cruz City 1 Mauritius Holdings* [2012] EWHC 3702. Most of those cases proceed on similar lines and emphasise that it would be "exceptional for the proper law of the arbitration agreement to differ from an express choice of law for the host contract" (*Channel Tunnel);* that an express choice of law clause governing the main contract is "likely to lead to the conclusion that the parties intended the arbitration agreement to be governed by the same system of law as the substantive contract, unless there are other factors present which point to a different conclusion." And that "The choice of a seat different from the law of the governing contract would not in itself be sufficient to displace [the] starting point" that the law of the arbitration agreement is the law governing the contract (*BCY v BCZ)*); that "the governing law of the main contract is a strong indicator of the governing law of the arbitration agreement" *(Sulamerica)* and that "the governing law clause is, at the least, a strong pointer to their intention about the law governing the arbitration agreement" *(Arsanovia).*

Kabab-Ji v Kout Food Group is consonant with this approach. It is, however, notable that the court emphasised that as a matter of interpretation there was an ***express*** choice for the arbitration agreement to be governed by English law. Accordingly, there was no need to ask whether there was an implied term to that effect, or to apply a "closest and most real connection" test as would otherwise be the case.

B. *ENKA v OOO*

Merely a month or two later the Court of Appeal handed down yet another decision on the correct approach to ascertaining the governing law of an arbitration agreement – *Enka v OOO*, a diagram of which is below.



In *Enka* the court accepted the position in *Kabab-Ji.* i.e. that as a matter of contractual interpretation the parties may have intended the arbitration agreement to be governed by the law of the main contract and that such a choice could constitute an express choice under limb 1 of the test in *Sulamerica.* But if there was no express choice of governing law, and *Kabab-Ji* didn't apply, then the court has to determine whether there was an implied choice of the law governing the arbitration agreement.

As to which, as we've already seen, the old *Sulamerica* judgment explained that where there is an express choice of law clause governing the main contract, that is likely to lead to the conclusion that there is an implied choice that the same law governs the arbitration agreement. Further, in *BCY v BCZ* the Singaporean courts went further and opined that a choice of seat different to the law governing the contract is not sufficient to displace the presumption that the law governing the contract should also govern the law of arbitration agreement.

In my view, that makes commercial sense: parties do not readily agree for different laws to govern different parts of a contract. But, oddly, Lord Justice Popplewell's decision in *Enka* now says the precise opposite. Of course, LJ Popplewell wasn't bound by the decision in Singapore and the Sulamerica case was made in the same court, but the judgment is, in some respects, surprising.

The background to the dispute is that Enka and OOO had contracted for the provision of services to build a power plant. The contract was (arguably) governed by Russian law, but provided for arbitration with the seat being England. A dispute arose and OOO sued Enka in the Russian courts arguing that the governing law of the arbitration agreement was Russian law and that, under Russian law the disputes in question fell outside the ambit of the arbitration clause. OOO argued that English law governed the arbitration agreement and applied for an anti-suit injunction against the Russian proceedings.

When addressing that question, Lord Justice Popplewell, determined to resolve the caselaw in this area. Indeed, at paragraph 89 of the judgment, he explained that, in his view: "The current state of the authorities does no credit to English commercial law which seeks to serve the business community by providing certainty." But in stark contrast to *Sulamerica,* he resolved that

where there was no express choice of law governing the arbitration agreement, if there is an express choice of seat, the law of the seat will almost always be the law governing the arbitration agreement: "…the general rule should be that the AA law is the curial law [i.e. the law of the seat], as a matter of implied choice…" [91].

Popplewell LJ gave three reasons for his decision. They are:

a) First, that there is no principled reason for treating the governing law of the contract as determining the law of the arbitration agreement. As to that I'm not sure that's really the right question to ask: there is certainly a commercial reason for leaning towards the arbitration agreement being governed by the underlying law of the contract – that is that commercial men and women don't readily intend for different laws to govern different bits of a contract. Further, where the parties haven't made express provision for the law governing the arbitration agreement, but they *have* made express provision for the law governing the contract, it is reasonable to assume that they meant the latter to govern the former.

b) Second, Poppplewell LJ opined that the scope of the curial law and that of the arbitration agreement overlapped because the curial law was not limited to questions of a purely procedural matter but could affect the substantive rights of the parties. While that is certainly true, I don't see that as justifying in any way a departure from point 1, it just reiterates that there is a choice to make. As to which I refer back to point 1, that commercial men and women don't readily intend to the law governing an arbitration agreement to be governed by different laws.

c) Thirdly, Popplewell LJ regarded the question of whether the seat should govern as one of implied choice under limb 2 of the test, not a closest and most real connection test under limb 3. While I can accept that, I again fail to see how that indicates that the law of the seat should prevail over the governing law of the contract.

This leaves us in the odd position of having two conflicting authorities both from the Court of Appeal, *Sulamerica* and *Enka* which say precisely the opposite in determining whether the governing law of the contract or the law of the seat should prevail. The *Enka* judgment also begs the question whether the only circumstances where one will ever need to rely on the third limb of the *Sulamerica* test is when there is no choice of seat. Because it now seems to be the case that where there is a choice of seat, that is the law governing the arbitration agreement.

Drawing these strings together, both the *Kabab-Ji* and *Enka* judgments in their different ways are likely to have repercussions for scenarios where there is a dispute as to what law governs the arbitration agreement and where, in turn, that affects whether the dispute in question is arbitrable and/or should be recognised and enforced.

It remains to be seen whether the *Enka* judgment is appealed to the Supreme Court, but it does seem ripe for the question to be clarified, in order to reconcile *Enka* and *Sulamerica*. In my opinion, the law is now arguably less clear than it was previously, now we have two competing Court of Appeal authorities that provide flatly opposing ratios.

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